PRINCE EDWARD ISLAND

BUDGET PAPER

BACKGROUND NOTES ON THE ECONOMY

2013-2014

Introduction

The following document is an update of the economic situation of the Province since the release of the Fall Economic Update. Primarily, this document is a retrospective on the economic performance of the preceding year. This release begins with a discussion of the international and national economic context of the past year, and then moves on to a detailed discussion of the Island's economic indicators. All information in this document is current to March 4, 2013.

International Economy

World economies are continuing to recover from the economic downturn and fiscal crisis. Policy actions in the United States and Europe have diminished risks in their respective jurisdictions. Europe remains in recession. The spending sequester in the United States that took effect March 1st, 2013, contains the risk of short-term fiscal contraction. According to the International Monetary Fund (IMF), to mitigate these risks, the movement toward further banking and fiscal integration must continue in the Eurozone, while in the United States, a credible medium-term fiscal plan must be developed, avoiding short-term fiscal shocks.

The world economy expanded by 3.2 per cent in 2012, slightly slower than the 3.9 per cent expansion in 2011 according to the IMF. Advanced economies grew by 1.3 per cent in 2012, while emerging market and developing economies expanded by 5.1 per cent. Growth in the world economy is expected to improve through 2013, with the IMF predicting economic output to expand in the order of 3.5 per cent. However, as in years past, this growth will be unevenly divided between developing and developed economies, with advanced economies growing by 1.4 per cent in 2013, while emerging economies are expected to grow by 5.5 per cent, led by strong growth from China, growing 8.2 per cent, and India, growing 5.9 per cent.

World Economic Growth Projections 2010-2013				
percent				
	2011	2012	2013	2014
World	3.9	3.2	3.5	4.1
Advanced Economics	1.6	1.3	1.4	2.2
Emerging Market and Developing Economies	6.3	5.1	5.5	5.9
India	7.9	4.5	5.9	6.4
China	9.3	7.8	8.2	8.5

Source: International Monetary Fund World Economic Update January 2013

Europe

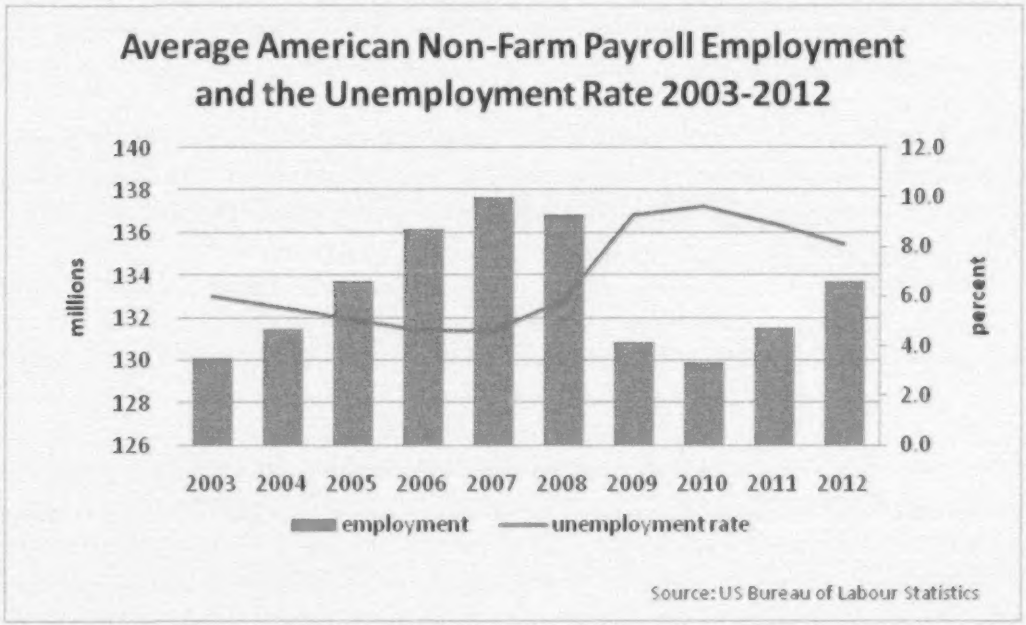
The Euro Area contracted by 0.4 per cent in 2012. Financial stress is diminishing as evidenced by bond spreads in the Euro Area periphery declining; however economic activity was also softer than expected, with some spill-over into the core areas of the Eurozone. Both Germany and France recorded growth in 2012, growing 0.9 and 0.2 per cent respectively, while the economies of both Italy and Spain contracted 2.1 and 1.4 per cent respectively.

The European economy is expected to continue to contract in 2013, shrinking by 0.2 per cent, due to the still elevated costs for private borrowers despite improvements in sovereign debt markets, and the uncertainty that continues to surround the ultimate resolution of the sovereign debt crisis. Employment remains an issue, with the unemployment rate in the Euro Area at 11.9 per cent as of January 2013, a new record. Political instability, most recently in Italy has revived with voters rejecting austerity measures, which may once again lead to pressure in the sovereign debt markets. Once again Germany and France are expected to see growth in 2013, by 0.6 and 0.3 per cent respectively, while Italy and Spain will see a second year of economic contraction, by 1.0 per cent and 1.5 per cent respectively. Growth is projected to return to the Euro Area in 2014, expanding by 1.0 per cent as some of the aforementioned effects continue to dissipate.

United States

After growing by 1.8 per cent in 2011, real GDP increased 2.2 per cent in 2012. Increases to real GDP were broadly based across most sectors of the economy. Detracting from GDP in 2012 were expenditures by federal, state and local governments.

The employment situation in the United States continues to improve. After expanding by 1.2 per cent in 2011, average non-farm payroll employment grew by 1.7 per cent in 2012, or 2.2 million jobs. Job gains, though modest have been sustained month to month, with employment growing every month since October 2010. Though the situation is improving, the United States remains approximately 3.9 million jobs below its pre-recession peak recorded in 2007.



After peaking in 2010 at 9.6 per cent, the average annual unemployment rate continues to trend downward in the United States, finishing 2012 at 8.1 per cent. Unemployment has been under 8.0 per cent since September of 2012, and finished the year at 7.8 per cent. This is still markedly higher than in the years prior to the recession. The number of unemployed persons as of December 2012 was 12.2 million. Of those people, the long term unemployed, those who have been out of work for more than 27 weeks, account for 4.8 million or nearly 40 per cent of the total unemployed.

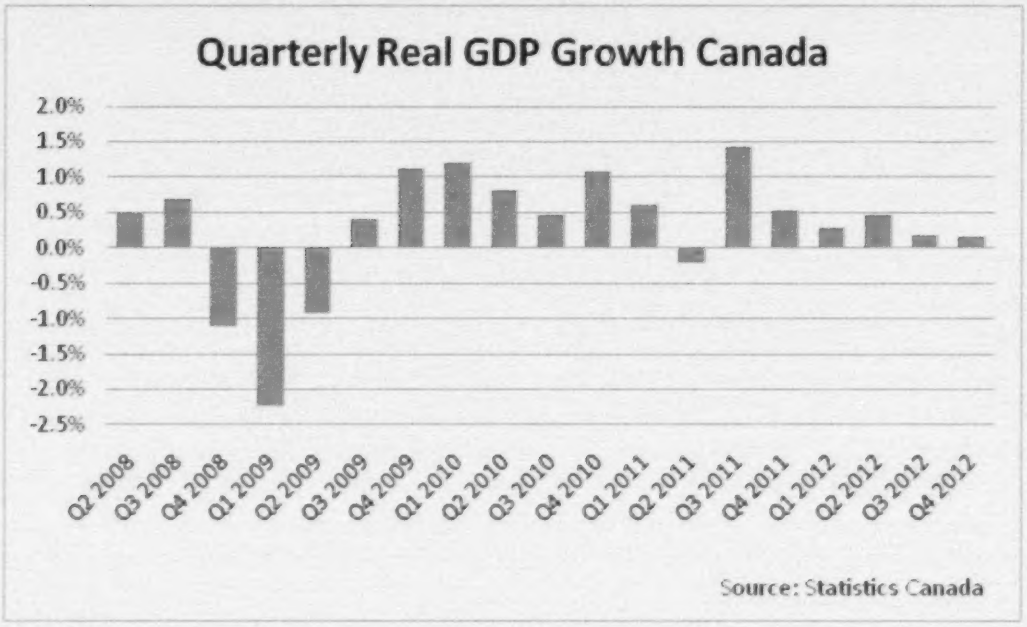
Though the economic situation in the United States is still improving, monetary authorities continued to intervene in financial markets. The mandate of the Federal Open Markets Committee (FOMC) is to foster an environment of maximum employment and price stability. At its January meeting the FOMC indicated that it intended to continue its accommodative policy of purchasing $40 billion of additional mortgage backed securities per month. They also launched a new initiative to purchase longer-term treasury securities at a pace of $45 billion per month. The FOMC indicated that it will continue to monitor economic and financial conditions to determine whether or not the continuation of this program is warranted. The FOMC also indicated that it will continue with its accommodative policy until there is a measurable improvement in the employment situation in the United States, which it identified as an unemployment rate below 6.5 per cent, contingent upon expected inflation one and two years ahead does not exceed 2.5 per cent, and long-term inflation expectations remaining well-anchored. The target for the federal funds rate has been at its lower bound since December 2010 and remains unchanged at 0-0.25 per cent.

Canadian Economy

The Canadian economy expanded in 2012 by 1.8 per cent in real terms after expanding 2.6 per cent in 2011. Since emerging from recession in the third quarter of 2009, the Canadian economy has seen seven quarters of economic growth, punctuated by one quarter of contraction in the second quarter of 2011, followed by six more quarters of growth.

Growth in 2012 has been supported by all major industries except arts and entertainment, and public administration. Goods production grew 1.9 per cent in 2012 led by construction, notably growth in residential building, and manufacturing, notably growth in transportation equipment. Service production grew 1.8 per cent in 2012, led by health care and social services, fire and insurance, professional services and wholesale and retail trade.

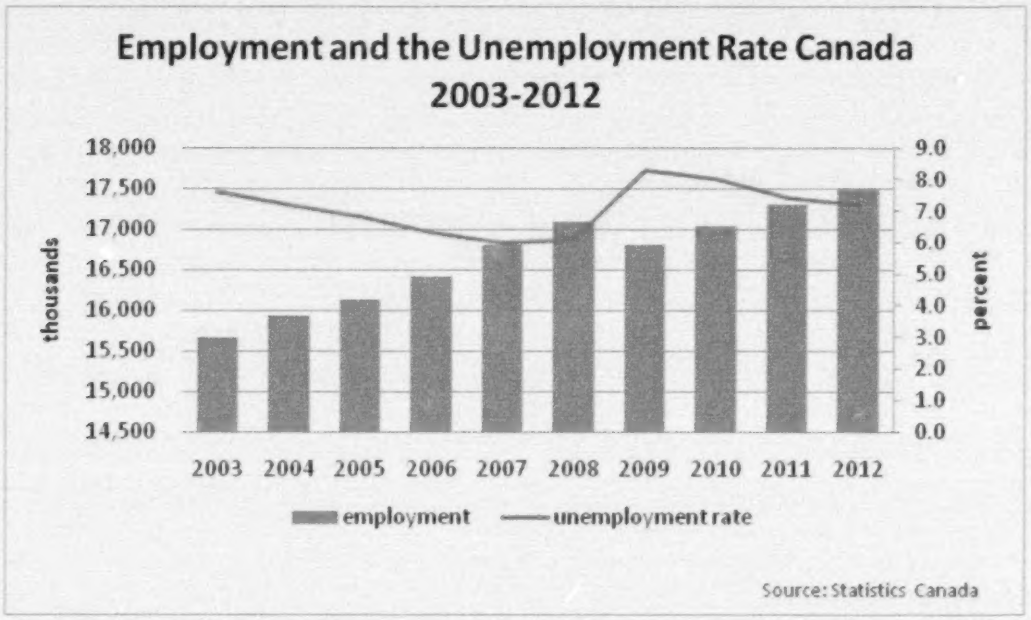
Household consumption spending increased 1.9 per cent in 2012, slower than the 2.4 per cent pace recorded in 2011. This increase was the result of increased purchases of durable goods and services. Business investments in residential structures advance 5.8 per cent in 2012, a much faster pace than the 1.9 per cent expansion in 2011. Business investment in plant and equipment advanced 6.2 per cent in 2012, slower than the 10.4 per cent pace recorded in 2011. The pace of government final consumption expenditures continues to decline, expanding by 0.4 per cent in 2012. Trade volumes slowed in 2012, with exports growing 1.6 per cent in 2012, compared to 4.6 per cent in 2011, while imports grew 2.9 per cent in 2012, compared to 5.8 per cent in 2011.



Employment in Canada

Employment in Canada increased by 201,500 jobs, or 1.2 per cent in 2012. This is the fourth year in a row employment has grown in Canada, and employment now sits 420,300 above its pre-recession peak. Employment gains in 2012 were all found in full-time work, which expanded by 1.6 per cent. Part-time work contracted in 2012 by 0.5 per cent.

Employment gains were recorded in both the goods and service sectors, expanding 1.8 and 1.0 per cent respectively. Notable employment gains include, educational services, up 5.6 per cent, other services, up 4.8 per cent and health care and social services, up 1.7 per cent, and other primary industries, up 9.5 per cent. Declines occurred in trade, down 1.0 per cent, public administration, down 1.6 per cent and professional, scientific and technical services, down 0.8 per cent. The unemployment rate averaged 7.2 per cent in 2012, a decline of 0.2 percentage points from 2011.



Consumer prices

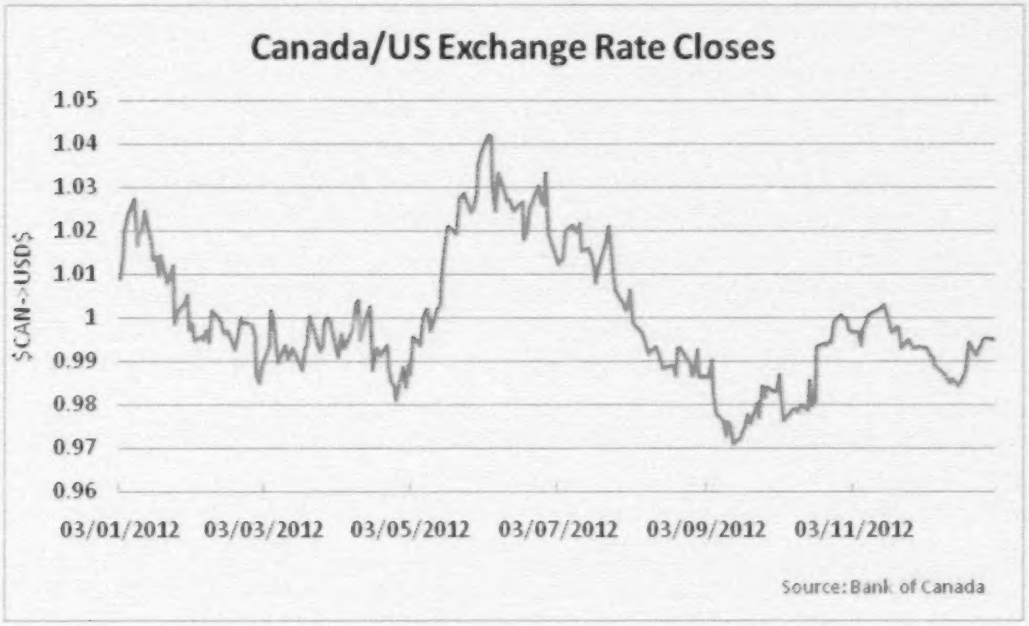
Inflation remains low, with the consumer price index increasing 1.5 per cent in 2012. Increases were seen across all components, with notable gains in food, up 2.4 per cent and transportation, up 2.0 per cent. Core inflation was 1.3 per cent in 2012, below the Bank of Canada's two per cent target. The Bank of Canada anticipates a return to the two per cent inflation target in the middle of 2014, as the economy returns to full capacity.

Interest Rates

The Bank of Canada, in its latest rate setting announcement on 6 March 2013, decided to keep the target for the overnight rate at one per cent, a level at which it has been since September 2010. Economic conditions are largely consistent with the Bank's January Monetary Policy Report, which indicated a deterioration in economic conditions from previous forecasts, both in Canada and abroad. Internationally, Europe continues to be in a recession and economic activity has been slowing in some emerging economies. The fiscal drag in the United States now appears to be more front-loaded than previously forecast due to the impact of the sequester. Domestically, a slowing in the pace of inventory accumulation offset growth across most other components of GDP resulting in more modest growth than anticipated. Moderate growth in household spending, exports and more robust investment by businesses should support growth through 2013. Core inflation has also been more muted than expected previously, while total CPI has also been lower than anticipated. Due to the softening inflation expectations, the timing of interest rate rises is less imminent than previously anticipated.

Foreign exchange

Throughout 2012, the Canadian dollar traded in a narrow band between 97 cents US, and 1.04 cents US, averaging 99 cents US. This narrow trading range has been common for the Canadian dollar over the last number of years. The continued strength of the Canadian dollar can be attributed to Canada's relatively strong economic and fiscal position, and uncertainty related to other developed economies. This sustained strength in the Canadian dollar is expected to continue due to safe-haven flows and the impacts of global monetary policy. This will continue to put pressure on the export-oriented sectors of the economy by making Canadian goods more expensive.



Highlights of the Prince Edward Island Economy

- Provincial GDP advanced 1.6 per cent in 2011. The average of private sector forecasts place 2012 real GDP growth at 1.4 per cent. The average GDP outlook for 2013 is growth in the range of 1.6 per cent.

- As a result of increased immigration, Prince Edward Island's population is estimated to be 146,105 as of July 1, 2012. This represents a yearly increase of 410 persons, or 0.3 per cent growth since July 1, 2011, the fastest growth in the Atlantic region.

- The total value of retail sales increased 3.4 per cent in 2012

- Employment has averaged 72,800 people in 2012, an increase of 1.1 per cent from 2011

- Total capital spending totalled $986.4 million in 2012, a decline of 8.9 per cent from 2011, as capital spending by government returns to more traditional levels

- The value of non-residential investment on Prince Edward Island declined 0.6 per cent in 2012

- Investment intentions are projected to increase by 7.1 per cent in 2013

- Housing starts totalled 941 in 2012 due to increases in multi-unit construction, the highest level since 1988

- Island potato producers produced 24.9 million hundredweight of potatoes in 2012, an increase of 1.7 per cent from 2011

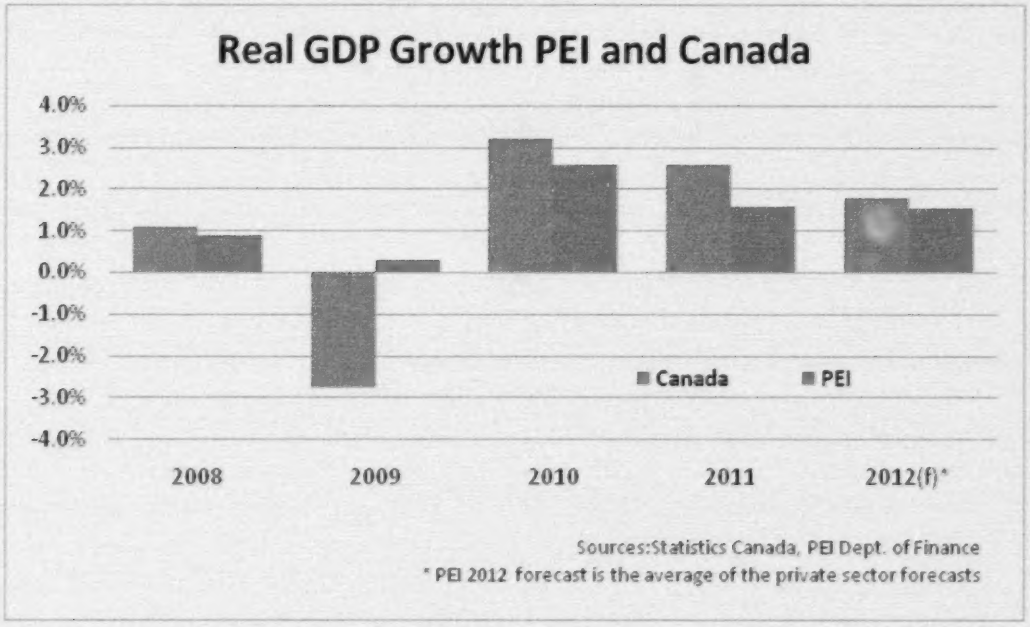
- The landed value of the 2012 lobster fishery increased from $84.5 million in 2011 to over $113 million in 2012, while the volume of lobster caught has increased from 20.5 million pounds to 27.2 million pounds.

- Night's sold at fixed roof accommodations decreased 2.0 per cent in 2012, while stays at campgrounds increased 4.4 per cent. Together, stays at fixed roof accommodations and campgrounds declined 0.1 per cent in 2012.

- Manufacturing shipments from PEI increased 5.8 per cent in 2012, while international exports have increased 15.2 per cent

Provincial Economy

Prince Edward Island's economic performance has been steady. Since 2007, Prince Edward Island has been the only province to record positive GDP growth in all years. Statistics Canada estimates that the Island economy expanded by 1.6 per cent in 2011. This was the fastest growth in the Maritime region. Growth was driven by a 4.2 per cent increase in final domestic demand. Gross fixed capital formation increased 15.4 per cent in 2011. Business investment in non-residential structures rebounded 46.6 per cent to return to pre-2009 levels, while investment in housing increased 5.9 per cent. Exports declined 1.2 per cent in 2011. The average of private sector forecasts place 2012 real GDP growth at 1.4 per cent. National growth for GDP over this period was 2.6 per cent.



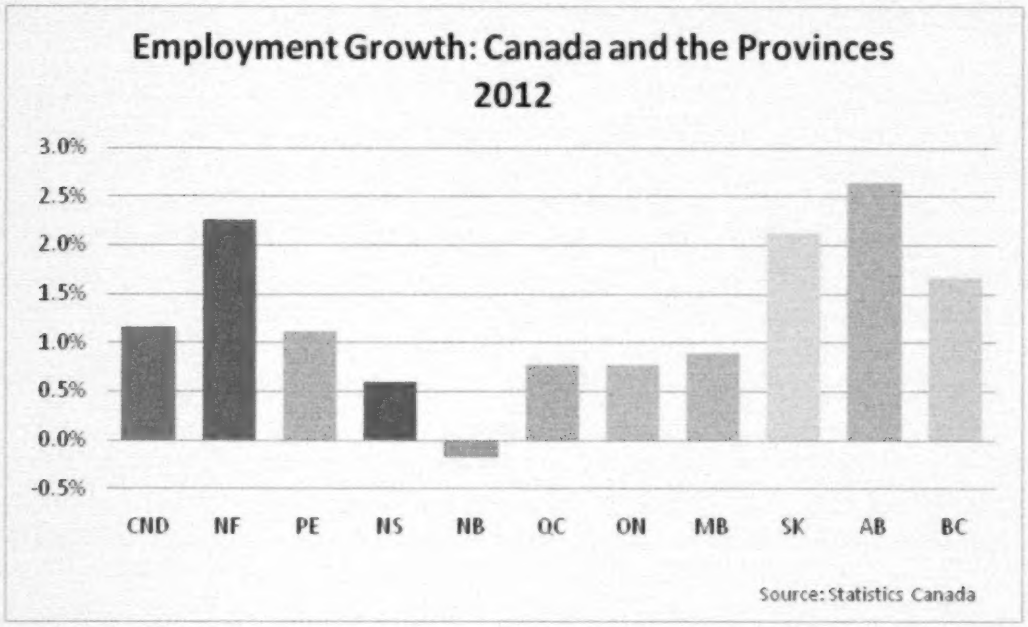
Employment and Jobs

According to the Labour Force Survey (LFS), employment averaged 72,800 people in 2012, an increase of 1.1 per cent over 2011. The unemployment rate averaged 11.3 per cent in 2012, unchanged from one year ago. Employment in 2012 increased in the service producing industries by 1.6 per cent, and declined in the goods-producing industries by 0.9 per cent. Notable employment gains can be found in health care and social assistance, up 8.4 per cent, professional, scientific and technical services, up 14.5 per cent, transportation and warehousing, up 12.0 per cent, and agriculture, up 8.2 per cent. Notable declines in employment were recorded in educational services, down 5.0 per cent, trade, down 3.2 per cent, and manufacturing, down 4.4 per cent.

Prince Edward Island's labour force continues to expand in 2012, up 1.0 per cent to average 82,000 persons. The participation rate has averaged 68.0 per cent, down 0.1 percentage points

from 2011, where it averaged 68.1 per cent. Prince Edward Island had the fourth highest participation rate amongst provinces behind only Alberta, Saskatchewan and Manitoba.

Employment increased in all provinces in 2012, except New Brunswick, where employment declined by 0.2 per cent. Alberta posted the strongest growth in employment, at 2.7 per cent, followed by Newfoundland and Labrador, Saskatchewan and British Columbia. At 1.1 per cent, employment growth on the Island was just shy of the national average of 1.2 per cent.



The number of jobs in the wage sector in Prince Edward Island continues to expand. According to the Survey of Employment Payroll and Hours (SEPH), the number of jobs on the Island has increased to 64,823, an increase of 0.3 per cent. Increases occurred in both the goods and service producing sectors, growing 1.9 and 0.2 per cent respectively. Notable gains can be found in public administration, up 4.4 per cent, manufacturing, up 4.3 per cent, and accommodation and food services, up 4.4 per cent. Notable losses can be found in health care and social assistance, down 1.9 per cent, construction, down 2.3 per cent and administration and support, waste management and remediation services, down 6.6 per cent. Average weekly earnings grew by 3.0 per cent in 2012.

Growth in the number of jobs and increases to wages have helped push up employee compensation by 3.4 per cent in 2012. Nationally, employee compensation advanced 4.2 per cent in 2012.

Retail Sales and Motor Vehicle Sales

Retail sales on Prince Edward Island totalled $1.9 billion in 2012, an increase of 3.4 per cent from 2011. Increases occurred across most components of retail sales, with the exception of

health and personal care stores, down 2.9 per cent, and gasoline stations, down 0.4 per cent. Sales at food and beverage stores – the single largest component of retail sales – increased 3.9 per cent.

With 6,236 units sold, 2012 was a banner year for new motor vehicle sales on Prince Edward Island. New motor vehicle sales in 2012 were the highest they have been since 1985. Sales increased by 441 units, or 13.9 per cent over 2011. The value of new motor vehicles sold increased 9.7 per cent. This increase was driven by increases in the value and volume of both passenger cars and commercial vehicles. Nationally, the sale of new motor vehicles increased 5.9 per cent, while the value of new motor vehicles sold increased 5.1 per cent.

The growth in sales on Prince Edward Island was the strongest in the Maritime region, with sales growing 1.0 per cent in Nova Scotia, and declining 0.5 per cent in New Brunswick, and second in the Atlantic region behind Newfoundland and Labrador, with sales growth of 4.8 per cent. Nationally, the growth in retail sales was 2.5 per cent in 2012.

Consumer Prices

The all-items consumer price index increased 2.0 per cent in 2012. Increases occurred across all major components with food increasing 4.1 per cent, shelter increasing 0.8 per cent, and energy increasing 3.2 per cent. Core inflation (the measure of inflation excluding volatile components such as energy and food) increased 1.2 per cent.

Construction and Housing

After increasing in 2011, total capital expenditures on the Island decreased by 8.9 per cent in 2012 to $986.4 million. Decreases were recorded in both construction, down 8.0 per cent, and machinery and equipment, down 10.1 per cent as stimulus spending began to wind down. Public capital expenditures decreased 26.3 per cent to $288 million. Construction decreased 23.2 per cent, while spending on machinery and equipment decreased 35.9 per cent. Private sector capital investment increased by 1.3 per cent in 2012 to $698.5 million.

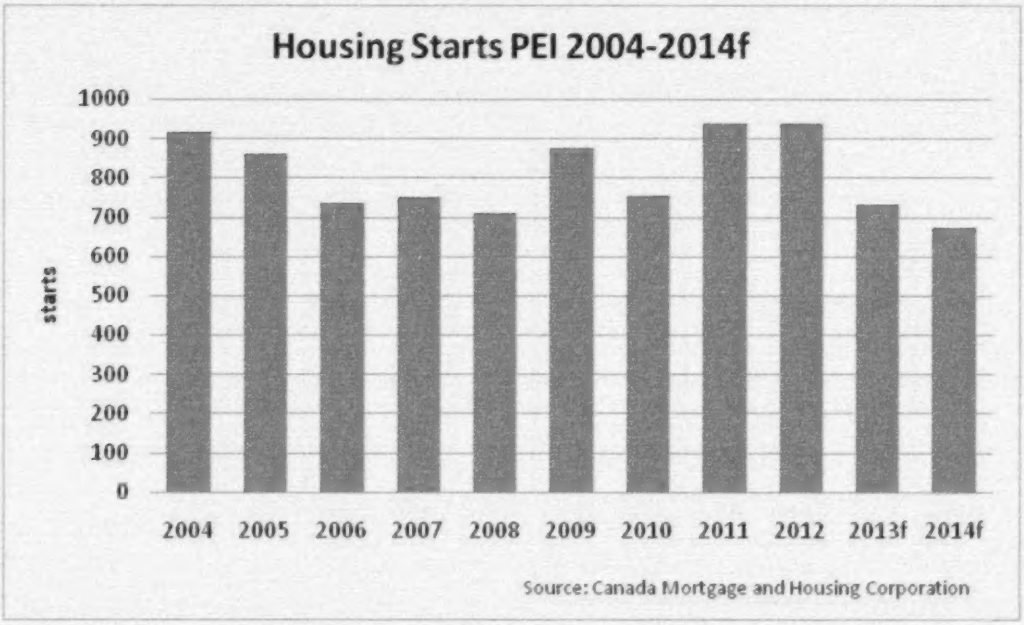
There was a 0.6 per cent decline in non-residential investment on the Island in 2012. Increases in both industrial and commercial investment of 34.5 and 14.3 per cent respectively could not offset a 29 per cent decline in government and institutional investment. Nationally, non-residential investment in 2012 advanced 2.2 per cent from a year earlier.

Following the best year since 1988, housing construction increased further in 2012 to total 941 starts, an increase of 0.1 per cent compared to 2011. An 8.8 per cent increase in multiple starts was just enough to offset the 10.2 per cent decline in single-detached starts. Within the multiple starts category, gains were recorded in both semi-detached homes, and row houses, while apartments saw a decline.

The value of residential starts continues to increase on the Island. Residential investment, totalled $330.2 million in 2012, an increase of 6.1 per cent from the same period in 2011. Gains were recorded in the multiple housing segment with apartments up 12.2 per cent, semi-

detached homes up 16.3 per cent and row houses up 56 per cent. The value of single detached starts declined 5.3 per cent in 2012. Renovation activity, the largest component of residential investment, continued to be strong on the Island in 2012, up 8.1 per cent, while conversions and cottages also saw gains. Total acquisition costs and investments in mobile homes declined in 2012.

After two years of elevated starts, CMHC forecasts a 21.9 per cent decline in starts for 2013. This decline is in following both regional, and national trends, as new construction in multiple starts, especially apartments are absorbed into the housing market. The point forecast from CMHC predicts that there will be 735 housing starts on the Island in 2013. Starts are projected to fall further in 2014, to 675. This decline is a result of decreases in both the number of multiple and single starts.



Manufacturing Shipment and Exports

Manufacturing shipments continue to recover on Prince Edward Island, increasing for the third year in a row. In 2012, shipment totalled $1.28 billion, a 5.8 per cent increase from 2011, just short of the pre-recession high recorded in 2007. Food manufacturing, which accounts for approximately 60 per cent of the Island's shipments, increased by 3.8 per cent in 2012, while non-food shipments increased by 8.6 per cent. Nationally, manufacturing shipments advanced 3.3 per cent.

The value of international exports from Prince Edward Island increased 15.2 per cent in 2012. This increase is broadly based across sectors. Traditional sectors such as frozen food manufacturing, and seafood product preparation and packaging rebounded in 2012, and have grown 14.4 and 14.9 per cent respectively. Newer sectors of the Island economy such as

engine, turbine and power transmission equipment manufacturing and aerospace products and parts manufacturing have shown continued strong growth throughout this time period. Both of these sectors also posted strong growth in 2012. Notable decreases in exports over this period include vegetable and melon farming, down 32.4 per cent and pharmaceutical and medicine manufacturing, down 6.6 per cent.

Primary Industries

Farming

There were 89,500 acres of potatoes planted on Prince Edward Island in 2012, an increase of 3,500 acres from 2011. Due to good harvest conditions, only 2.2 per cent of the crop was not harvested. Farmers produced 29.4 million hundredweight of potatoes in 2012, up 1.7 per cent from 2011. Dry weather through the summer resulted in smaller yields for some early season varieties of potato, but rains later in the fall have meant that the yield for later varieties of potato was better than was expected.

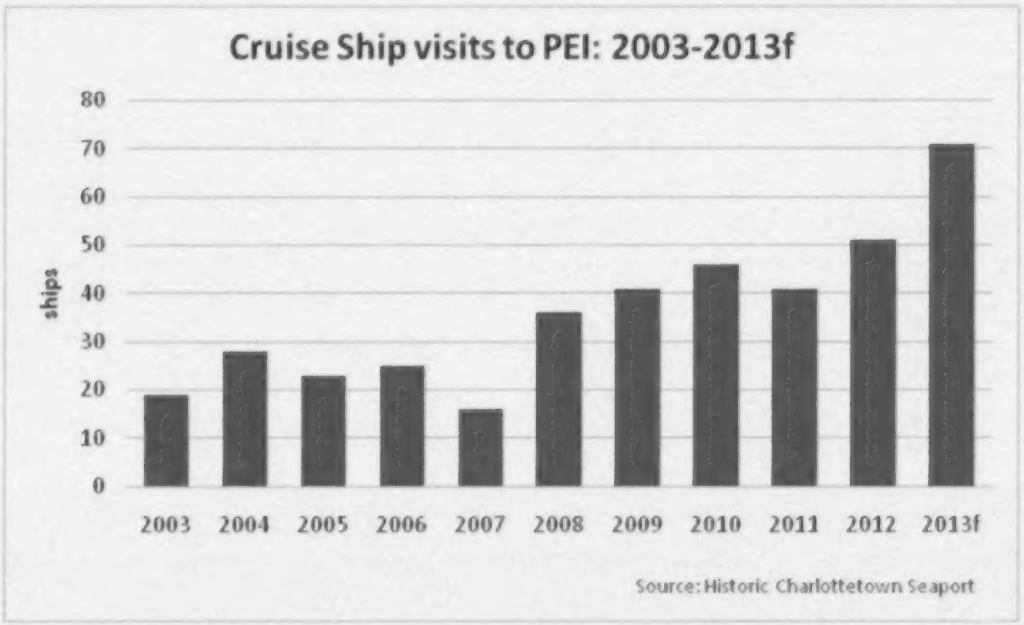
The price of average commercial potatoes increased 3.8 per cent in 2012, while the price of seed potatoes increased 3.6 per cent compared to 2011. The price of soybeans, the second largest crop by value, and seeded area on the Island, increased by 20.1 per cent between 2011 and 2012. The price of both slaughter and feeder cattle increased between 2011, and 2012, by 11.8 and 9.2 per cent respectively. The prices of both chickens and eggs rose 3.8 and 7.0 per cent respectively. The price of hogs declined 3.4 per cent, while the price for milk declined 0.7 per cent.

Fishing

The landed value of the 2012 lobster fishery increased from $84.5 million in 2011 to over $113 million in 2012, while the volume of lobster caught has increased from 20.5 million pounds to 27.2 million pounds. Lobster accounts for approximately sixty per cent of the landed value of the fishery on Prince Edward Island.

Tourism

Cruise ship traffic to the Island continued to increase in 2012. A total of 51 ships with just over 99,000 passengers and crew visited Prince Edward Island in 2012, a 24.4 per cent increase in the number of ships visiting the Island and a 10 per cent increase in the number of passengers and crew compared to 2011. A further six ships planned to visit the Island in 2012, but weather-related issues prevented their arrival. Cruise ship traffic is expected to further increase in 2013, with 71 ships bringing 135,051 passengers and crew to the Island. This represents a 39.2 per cent increase in boat traffic, and a 36.4 per cent increase in the number of passengers and crew. Air and ferry traffic grew 4.3 and 2.0 per cent respectively in 2012, while bridge traffic declined 0.6 per cent.



Occupancy rates at Island accommodations deceased by 1.0 percentage point, while the number of room-night's sold decreased by 2.0 per cent. Camping, continued to do well in 2012, with site night's sold up 4.4 per cent, and the occupancy rate up 0.7 percentage points. Taken together, total night's sold on the Island have declined 0.1 per cent.

Sales at food service and drinking places on Prince Edward Island increased 4.2 per cent through November of 2012. Nationally, sales at food service and drinking places increased 5.2 per cent over the same time period.

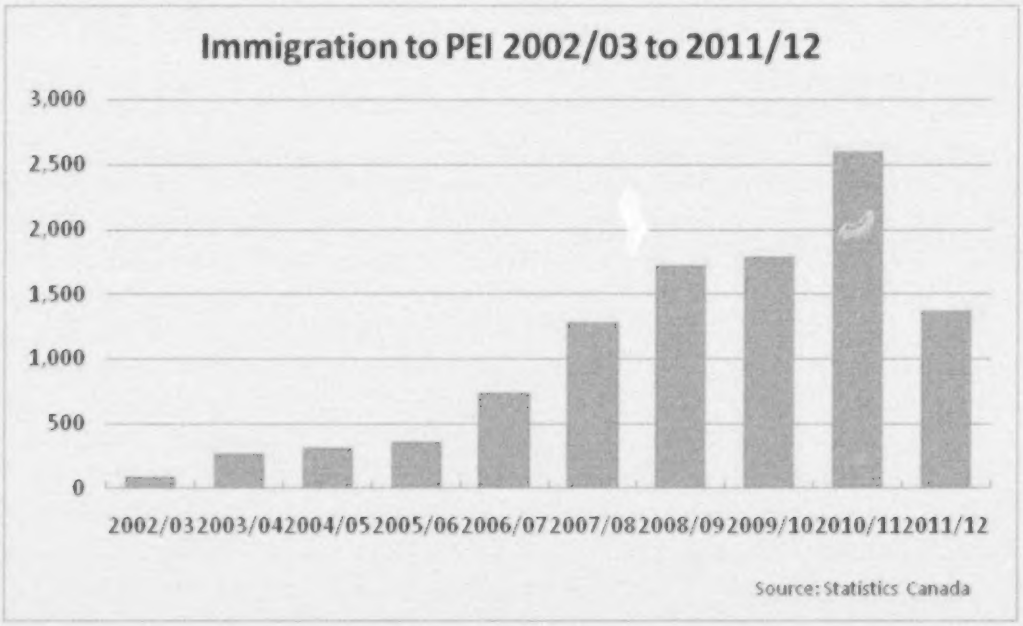
Population

As of July 1, 2012, Prince Edward Island's population is estimated to be 146,105. This represents a yearly increase of 410 persons and a 0.3 per cent annual growth rate. Prince Edward Island's rate of growth during this period was the highest in Atlantic Canada, but below the national rate of 1.1 per cent.

Population growth on Prince Edward Island is the result of international immigration. During this period 1,379 international immigrants came to the province, a decrease of 47 per cent from the previous year. This was the first decrease in international immigration since 2003. Developments in immigration policy means that Prince Edward Island can expect approximately 1,100 immigrants to arrive per year for the foreseeable future. This level is lower than the recent high's, but higher than the Island's historical average.

Prince Edward Island saw net inter-provincial out-migration of 1,252 in 2012. There were 2,901 inter-provincial migrants who came to PEI in 2012, while 4,153 people left the province for

other areas of Canada. There were 1,420 births and 1,344 deaths on Prince Edward Island from July 1, 2011 to June 30, 2012, resulting in natural growth (births minus deaths) of 76.



Outlook 2013

Due to the industrial mix found on Prince Edward Island, and strong domestic demand, the economic situation on the Island has been more stable compared to other parts of the country. Though many of the downside risks identified in previous reports have materialized, it is not expected that the world economy will return to recession, though slower growth than initially thought will persist throughout advanced and emerging economies in 2013.

The economic outlook for Prince Edward Island is that growth will continue at the modest pace of approximately 1.6 per cent in 2013. The goal of the Provincial Government is to expand the economy to $6 billion by 2016. The domestic economy, which has supported economic expansion over the last number of years, will face more pressure in the coming year. Employment growth is expected to be positive, but will slow on the Island in 2013. Federal and provincial job reductions will limit employment growth in the near term. Immigration levels are forecast to decline in 2013 compared to recent record levels as the effects from the changes to the provincial nominee program continue to be felt. Immigration is projected to be approximately 1,100 persons per year going forward – higher than the historical average – but lower than recent years. Improved international immigration programs will help the province to reach its goal of 75,000 people employed by 2016, and its target of raising the population to 150,000 people by 2022.

Both the manufacturing and export industries on the Island are expected to contribute positively to GDP in 2013. The extension of the aerospace tax credit for a further ten years will

help that sector remain internationally competitive, while the outlook for sales suggests that 2013 will be one of the stronger years on record. The sector has been quite successful in bringing new companies and opportunities to the Island, and this is a trend that is likely to continue in 2013. New investments in personnel, and machinery and equipment should help the bioscience sector continue to contribute positively to the Island economy in 2013. The outlook for some of the traditional industries on the Island, such as food processing is fairly constant for 2013, though lower prices and an abundance of potatoes in the United States will place pressure on Island growers, especially those supplying the fresh potato market.

Cruise ships will continue to be a positive boost to the tourism sector, and the Island economy, while the opening of the Prince Edward Island Convention Centre in Charlottetown in the summer of 2013 will provide capacity to host larger events.

The survey of public and private investment intentions indicates that capital expenditures are expected to increase 7.1 per cent in 2013. This increase is due to increases in both construction, up 5.0 per cent, and machinery and equipment, up 11.7 per cent. Strong growth in public component of construction and machinery and equipment purchases is due in part to the proposed 30MW Hermanville-Clear Springs wind farm. Contingent on approvals, this $60 million dollar project will be completed in 2013.

Private sector investment intentions are projected to decline 0.5 per cent in 2013. A 0.1 per cent increase in machinery and equipment intentions is not enough to offset a 0.9 per cent decline in construction intentions. Housing starts are projected to decline in 2013 due to lower single and multiple starts.

The introduction of a harmonized sales tax (HST), effective April 2013, is intended to level the playing field for business operation on Prince Edward Island. According to a report by University of Calgary professor Jack Mintz, the HST will help spur business investment resulting in an increase in higher paying jobs on Prince Edward Island.

Steps toward the resolution of the fiscal issues in the United States, notably the impending sequester, and a final resolution to the European sovereign debt crisis could provide upside risk to the forecast by improving market conditions and restoring confidence in the economy. A sustained lower value for the Canadian dollar could provide some relief to exporters currently struggling with high export costs. However, a further deterioration in either Europe or the United States could substantially weaken growth prospects going forward on a global basis.

Notes